

Avoided Cost Study and Resale
Discount Calculation
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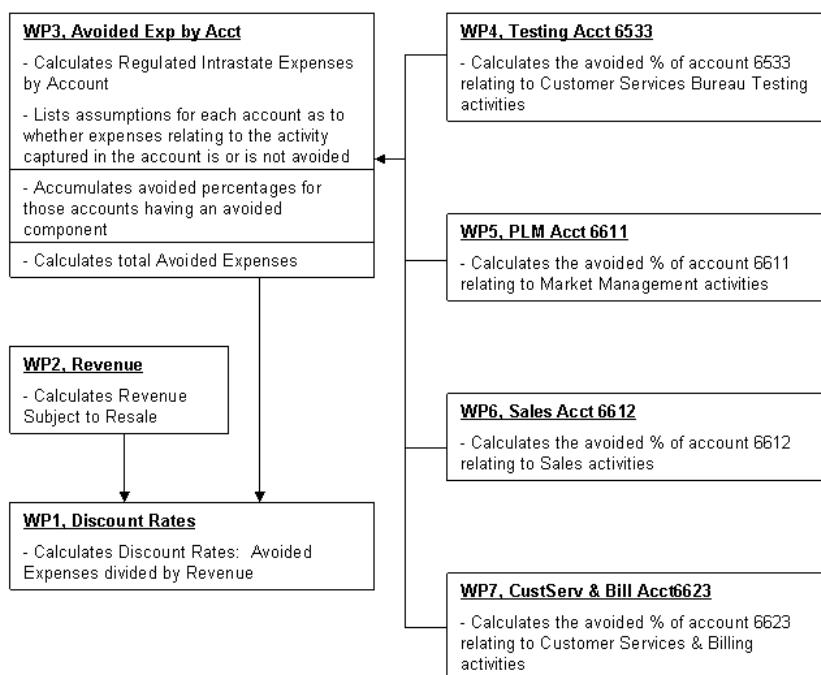
Massachusetts 2005 Avoided Cost and Resale Discount Study

Introduction

The Resale Discount Study calculates the discounts that apply when Verizon Massachusetts's ("Verizon") intrastate retail telecommunications services are resold by carriers pursuant to section 251(c)(4) of the Telecommunications Act of 1996.

Verizon calculates the resale discount by dividing total Regulated Intrastate Avoided Expenses (includes marketing, billing & collection and other expenses that are actually avoided when services are offered for sale at wholesale rates) by total revenues of services available for resale.

The resale discount is calculated in Exhibit 1, Workpapers ("WP") 1 - 7. A graphical representation and detailed description of the avoided cost study follows in the remainder of this document.



Resale Discount Calculation Flow

Part 1. Regulated Intrastate Expenses

Verizon's Regulated Expense data for the 2005 calendar year are obtained from the FCC's Automated Reporting Management Information System (ARMIS). Regulated ARMIS expense data are used as the starting point in determining the avoided costs for Verizon. **See WP3, Column D** for Regulated Expenses.

Before calculating avoided expenses, an intrastate percentage is applied to Regulated Expenses. Verizon's expenses are allocated between the state and interstate jurisdiction through the separations process. State expenses are recovered via state charges, consisting generally of retail charges and wholesale charges. Interstate expenses are recovered through interstate charges, which generally consist of Switched Access charges, Special Access charges and End User Common Line charges (EUCL). The state resale discount is calculated using the expenses that are recovered in the state rates. Moreover, the calculated state resale discount will not apply to those services that are purchased pursuant to interstate tariffs. The Intrastate % from ARMIS Report 43-04, Table I, Separations and Access Data is entered into Column E and multiplied by Regulated Expense in Column D resulting in Regulated Intrastate Expenses, Column F. **Refer to WP3, Avoided Exp by Account.**

Part 2. Avoided Expense Calculations

Overview

When telecommunications services are offered for sale at wholesale rates, costs will be avoided in five functions in the following USOA accounts:

1. Testing/Trouble Report Processing, Account 6533
2. Market Management, Account 6611
3. Sales, Account 6612
4. Customer Services excluding Billing Operations, Account 6623
5. Billing Operations, Account 6623

The percent avoided for each function is calculated in the avoided cost study and is described in more detail in this section.

2a) Avoided Testing Expenses in Account 6533

The testing expenses that will be avoided are those associated with Testing Subscriber Repair (or Trouble) Reports. This includes the subscriber line testing associated with receiving, recording and analyzing customer trouble reports. With resale, an end-user customer's call to report a trouble, currently made to the Verizon Repair Service Center, will now go directly to the reseller. In addition, the reseller will perform the initial trouble testing that is currently handled by Verizon Customer Services Bureau (CSB). Therefore, the Testing Subscriber Reports and related support expenses in account 6533 will be avoided.

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In order to determine the avoided expenses in 6533, Verizon examines the sub-account detail obtained from the financial systems database. In Verizon MA, these expenses are primarily limited to Subaccount:

- 65330000 – Tstng Ex-Cust Trbl Rprts Tst-Common

This subaccount is identified as 100% avoided since these costs are sensitive to the volume of customers and the reseller will provide this activity for its customers. The remaining Account 6533 Subaccounts in Verizon MA are related to network testing and are not avoided.

(See WP4, Testing Acct 6533)

2b) Avoided Market Management Expenses in Account 6611

Account 6611 includes costs incurred in performing administrative activities related to marketing products and services. This includes competitive analysis, product and service identification and specification, test market planning, demand forecasting, product life cycle analysis, pricing analysis, and the identification, establishment and ongoing management of distribution channels. Using Jobcodes from Verizon's HR System, headcount can be separated into three functional categories as follows:

Market Management/Segmentation/Forecasting - This functional category includes work and costs associated with:

- Developing marketing programs and strategies to maximize sales and competitive position in various channels.
- Enhancing market positioning and financial success of the channel in assigned markets.
- Researching and analyzing the company's markets, competition, and product mix.
- Analyzing the competitive environment and future trends.
- Developing, designing and coordinating sales proposals.

The costs associated with Market Management have been identified as avoided because they are considered variable, i.e., dependent upon market share or customer base. As Verizon loses market share, market management costs are assumed to be avoided.

Product Management/Pricing/Branding - This functional category includes work activities and costs associated with:

- Interfacing with engineering, manufacturing, and sales to develop new products or enhance existing product(s) or product line(s).
- Planning and implementing "Verizon" marketing communications projects in the areas of advertising and promotional programs, public relations and trade shows; developing and implementing plans for promoting the "Verizon" brand.
- Developing specific marketing plans and activities for specific product(s) or product line(s) to establish, to enhance or to distinguish product placement within the competitive marketplace.
- Developing business plans and product positioning in the marketplace.
- Pricing company products and services.

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These costs are not avoided since they must continue to be performed to assure that new products are developed and existing products enhanced to meet future demand. This is the case whether the customer is an end user or a reseller. The same products must be developed, delivered and managed for both retail and wholesale customers.

For example, functions such as rate and tariff development and identifying product requirements through a product's lifecycle are required to create and maintain a viable product that will be successful in either retail or wholesale markets. If these functions were not performed, Verizon would not have viable products to sell, either to Verizon's or Reseller's customers. These costs are, therefore, not avoided.

Because marketing expenses are predominately people-oriented (salary and wage), the amount of Account 6611 avoided expense is calculated by taking a ratio of Avoided Headcount divided by Avoided and Not-Avoided headcount.

Note: Some employees perform functions that cannot be classified into one of the Marketing Sub-Functions. In the avoided cost calculation, expenses associated with these employees are neither avoided nor not-avoided. In this way a portion of the General Marketing expenses become avoided, based on the relationship of avoided-to-avoided plus not-avoided costs. **(See WP5, PLM Acct 6611).**

2c) Avoided Sales Expenses in Account 6612

Sales Expenses are not avoided in their entirety when services are offered for resale at wholesale rates. The sales expenses associated with wholesale delivery services will continue to be incurred and therefore will not be avoided. However, the portion of sales expense incurred in performing activities relating to the selling of products and services directly to retail customers, such as the determination of individual customer needs, development and presentation of customer-specific proposals, sales order preparation and handling and preparation of sales records will be avoided.

The portion of Account 6612 Intrastate Expenses identified as avoided is based on a Verizon wide study of sales expense aggregated by Line of Business (LOB). The LOB structure in Verizon is organizationally established to better manage the business. LOBs in Verizon Domestic Telecom include:

- Corporate
- Enterprise Solutions
- Information Technology
- Retail Markets
- Network Services
- Human Resources
- Partner Solutions (f/k/a Wholesale Markets)

Sales expense by LOB is obtained from Verizon's financial systems. The percentage of Account 6612 Intrastate Expenses avoided is the sum of amounts assigned to Retail

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LOB's (Retail Markets and Enterprise Solutions) divided by the total of all 6612 expenses. (See **WP6, Sales Acct 6612**)

2d) Avoided Expense in Account 6623

USOA Account 6623 contains expenses for two primary functions:

- Customer Services and
- Billing Operations.

First, a special study was conducted to allocate USOA account 6623 expenses into Customer Services and Billing Operations. (See **WP7, CustServ & Bill Acct6623, Line 91**). Each sub-category (Customer Services and Billing Operations) is then examined separately.

Customer Service expenses include those costs associated with preparing, changing, and processing customer related service orders. In addition, they include expenses associated with collecting revenues and handling miscellaneous customer relations such as billing and account inquiry, customer instruction, annoyance call complaints, and updating customer records.

In order to determine the amount of Avoided Customer Services expense, Verizon examines the sub-account detail for account 6623 obtained from the financial systems. Verizon's financial accounting systems provide a short description of sub-accounts that flow to the USOA 6623. Verizon assigns the expenses associated with each sub-account into Retail, Wholesale, and Unspecified Categories. Retail-classified costs include those associated with End-users, Business/Residence Customers and Public PayPhone Customers. Wholesale-classified costs include those associated with Interexchange Carriers, CLEC and reseller customers. Unspecified would be anything that involves administrative services for retail and/or wholesale services, or for Billing Operations that will be determined in the secondary analysis for USOA 6623.

The percentage of avoided Customer Services Expenses in Account 6623 Intrastate Expenses is the sum of amounts assigned to retail sub-accounts divided by the total of amounts assigned to retail plus wholesale sub-accounts.
(See **WP7, CustServ & Bill Acct6623, Line 89**)

The amount of Billing Operations expense assigned to retail and wholesale services utilizes minutes-of-use studies, an indicator of how much retail versus wholesale usage is billed annually. (See **WP7, CustServ & Bill Acct6623, Line 93**).

The amount of Avoided total 6623 expenses is the weighted average of the two 6623 components (See **WP7, CustServ & Bill Acct6623, Line 94**).

2e) Avoided Operator Systems Expense in Accounts 6220, 6621, 6622

Verizon calculates the resale discount under two assumptions. The first assumption is that the reseller uses Verizon's operator services platforms; the second assumption is that the reseller uses its own operator services platforms.

If the reseller uses Verizon's operator services platforms, none of the expenses in accounts 6220 (Operator Systems), 6621 (Call Completion) and 6622 (Number Services) are avoided.

If the reseller uses its own operator services platforms, 100% of the expenses in accounts 6220 (Operator Systems), 6621 (Call Completion) and 6622 (Number Services) are avoided.

Part 3. Revenue

Overview

The denominator in the resale discount calculation includes revenues for all retail telecommunications services that must be offered for resale at wholesale prices. The following classes of revenues were excluded from the denominator:

1. Not retail;
2. Not subject to resale at discount rates; or,
3. Not a telecommunications service.

Categories specifically excluded from the denominator include:

- Non-retail revenues – These revenues are removed since the resale discount is applied to retail tariff rates.
- Access revenues - These services are not subject to the resale discount since they are not generally available to the public as required in the definition of telecommunications services. Additionally, the FCC mandates that the IXC must “purchase access services from incumbent LECs outside of the resale framework of 251(c)(4), through the existing interstate access tariffs.” (Local Comp Order, 980)
- End User Common Line (“EUCL”) revenues – Per the FCC, the EUCL is not subject to the resale discount rate. “Although incumbent LECs may continue to recover the [EUCL] when other carriers resell their local exchange services, the [EUCL] is not subject to the wholesale pricing standard of section 252(d)(3).” (Local Competition Order, ¶984).
- Nonregulated services revenues - These revenues, as identified in FCC Part 64 Separation of Regulated and Nonregulated Costs, are associated with services that are not Retail telecommunications services (e.g., the installation or repair of customer premises inside wiring).
- Billing and Collection Service revenues - This service, which provides billing and collection services such as invoice billing to other service providers, is not a telecommunications service.
- Miscellaneous Operating Revenues - These revenues are removed since they are not associated with telecommunications services. They are revenues associated with Rents, Corporate Operations Activities, and Other Incidental Regulated Charges.
- Other revenues – Revenues associated with Commercial Mobile and other Mobile revenues have been removed.

- All Interstate revenues – These have been removed since the Resale Discount applies only to intrastate services.

In order to determine the amount of revenue to include in the denominator of the resale discount calculation, Verizon first obtains the sub account revenue detail from the Company financial systems. Only those sub accounts that qualify as “retail telecommunications services that must be offered for resale at wholesale prices” are included. Next, any amounts that are non-regulated or interstate are removed. The percentages for non-regulated and interstate amounts are obtained from ARMIS. Finally, the amounts of adjusted revenue are summed to arrive at the denominator to use in the calculation (**See WP2, Revenue**).

Part 4. Resale Discount Calculation

Overview

Verizon calculates the resale discount by adding all of the avoided expenses and dividing by total applicable intrastate revenues. Two calculations are presented:

- Assuming the reseller uses Verizon’s operator services platforms (Operator Systems, Call Completion and Number Systems expenses are not avoided);
- Assuming the reseller uses its own (or a third party’s) operator services platforms (Operator Systems, Call Completion and Number Systems expense are avoided).

(**See WP1, Discount Rates**)